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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (October 1, 2022–December 31, 2022)

*By Kenneth M. Silverman and Brian Katz**

This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from October 1, 2022 through December 31, 2022.

This quarter, the SEC proposed 8 new rules and approved 7 final rules. The SEC's latest rule changes and proposals are largely geared toward streamlining disclosure processes. Given the recent collapse of cryptocurrency exchange FTX and related actions that came to light during this quarter, we expect the SEC will begin to develop and propose new rules to regulate and provide further oversight over cryptocurrency markets. The SEC nearly doubled its Crypto Assets and Cyber Unit this year by adding 20 people. The SEC is expected to take a much more proactive approach to cracking down on the cryptocurrency industry.

Final Rules

SEC Adopts Amendments to Modernize Fund Shareholder Reports and Fee Disclosures

On October 26, 2022, the SEC adopted amendments that require mutual funds and exchange-traded funds (collectively, "open-ended funds") to circulate concise and easily digestible shareholder reports that highlight key information and expenses. These amendments stem from proposals first issued in 2020 that sought to modernize fund shareholder reports and investment company advertisements to make such publications more accessible to the general public. These amendments generally do not extend to investment companies that are not registered on Form N-1A, such as closed-end funds, business development companies

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*Mr. Silverman and Mr. Katz are members of the New York Bar and Partners at Olshan Frome Wolosky LLP. Associates Scott Kilian-Clark, Zachary Freedman and Law Clerk David Breyer assisted the authors.

("BDCs"), unit investment trusts or issuers of variable annuity contracts.

The final rules add a new Item 27A to Form N-1A and amend disclosure frameworks for open-ended funds to provide for more concise annual and semi-annual reports by (i) highlighting pertinent information such as fund expenses, performance, illustrations of holdings and material fund changes, (ii) encouraging the use of graphic or text features such as tables, bullet point lists and Q&A formats, (iii) limiting the information that may be contained in Item 27A such that these reports maintain a concise nature and (iv) allowing for more user-friendly and interactive electronic versions of shareholder reports. The final rules require funds that file Form N-1A to prepare separate shareholder reports for each series of a multi-series open-end fund and requires separate shareholder reports for each class of shares of a multi-class fund.

In addition, new Item 27A amends the definition of an "appropriate broad-based securities market index." This definition change requires that open-end funds compare their performance to the overall applicable domestic or international equity or debt markets, as appropriate, for purposes of both fund annual reports and prospectuses. Providing further insight into its interpretation of this revised definition, the SEC specifically called out indices that include characteristics such as "growth," "value," "ESG," or "small- or mid-cap" as not being appropriate broad-based securities markets under the final rules.

In contrast to the current framework, open-ended funds can no longer rely on Rule 30e-3, which permits such funds to satisfy their shareholder report transmission requirements by making such reports and materials available online and providing shareholders with a notice of online availability, also known as notice and access delivery. Going forward, open-ended funds must directly deliver such reports and materials to the shareholders in paper format or electronically, at the shareholder's request.

Finally, the final rules require that presentations of investment company fees and expenses that are provided in advertisements and sales literature be consistent with relevant prospectus fee table presentations and be reasonably current. The SEC will also start taking a closer look at the representations made by funds when describing such fund's fees and expenses in advertisements and sales literature to ensure the descriptions are not materially misleading. These amendments regarding fees and expenses will apply to all registered investment company and BDC advertisements.

The SEC has provided for a transition period before the amendments go into effect, allowing funds time to comply and adjust for

the new framework. These amendments will go into effect on July 24, 2024. However, the amendments related to the representations of fees and expenses in advertisements and sales literature will go into effect on January 24, 2023.

SEC Adopts Rules to Enhance Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Say on Pay Matters

On November 2, 2022, the SEC adopted amendments to Form N-PX to add new disclosure and formatting requirements for institutional investors and registered funds, including a requirement that institutional investment managers report their votes relating to executive compensation.

Largely adopted from amendments first proposed in September 2021, the final rules require registered funds and institutional investment managers to provide more detailed information on proxy votes in Form N-PX filings by mandating a standardized, machine-readable (XML) format. Reporting persons must use language that mirrors the verbiage and order of voting matters as the original form of proxy. Reporting persons must further categorize the voted-upon matters within one of 14 specified categories. Registered funds will be required to disclose the number of shares voted or instructed to be voted and the number of shares loaned but not recalled (and therefore not available to be voted by such funds).

The rulemaking also imposes a new requirement that institutional investment managers that file reports under Section 13(f) of the 1934 Act must disclose how they vote on executive compensation, or so-called "say-on-pay" matters. The scope of the new reporting requirements also includes votes regarding "golden parachute" compensation in connection with a merger or acquisition. Joint reporting of voting on these executive compensation matters among managers and funds will be permitted on the new Form N-PX, but certain disclosure requirements to facilitate the identification of a particular manager's voting record are imposed.

Managers and funds will be required to file their first reports on the amended Form N-PX by August 31, 2024, with reports covering the period of July 1, 2023 to June 30, 2024.

The amendments are intended to provide investors with more detailed information about proxy votes and enhanced accessibility by standardizing the format of disclosures across reporting companies. As a result, the amendments may lead some investors to change how they allocate capital across funds to better match their preferences.

These amendments to Form N-PX directly reflect the SEC's

ongoing efforts to fulfill the mandates imposed by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") and broader interests articulated by the SEC in recent years in increasing reporting oversight of funds and managers.

Listing Standards for Recovery of Erroneously Awarded Compensation

The SEC adopted rules on October 26, 2022 to require securities exchanges to adopt new listing standards that will require listed issuers to develop and implement policies providing for the recovery of erroneously awarded incentive-based compensation received by current or former executive officers.

The rulemaking implements a new Section 10D of the 1934 Act, made partially in response to mandates added by the Dodd-Frank Act. Rule 10D-1 will require exchanges to establish and refine listing standards that require issuers to: (i) develop and implement written policies for the recovery of erroneously issued incentive-based compensation based on financial information required to be reported under securities laws during the three fiscal years immediately preceding the date that the issuer is required to prepare an accounting restatement; and (ii) disclose their compensation recovery polices in accordance with SEC rules. Non-compliant issuers will be subject to delisting.

Clawback Provisions

The new rules require that issuers listed on national securities exchanges implement rules to allow recovery of incentive-based compensation received by executives as a result of erroneous financial reporting, with a three-year lookback period. All executive officers identified in an issuer's proxy statement or Form 10-K pursuant to Regulation S-K Item 401(b) would be subject to potential clawbacks, regardless of whether they have any role in financial reporting. The forms of incentive-based compensation subject to clawback include any compensation granted, earned or vested and based at least in part upon a financial reporting measure. Examples of relevant financial measures for incentive-based compensation set forth in the final rules include those derived from GAAP and non-GAAP measures, such as EBITDA and segment-specific measures relative to a peer group (e.g., segment profitability). The amount of compensation subject to clawback would be the difference between applicable compensation awarded and compensation (if any) that would have been earned using the restated financials. The provisions do not account for any taxes that may have been paid on such compensation. Executives subject to such clawbacks will likely

have difficulty recouping any losses incurred from already paid taxes. Furthermore, issuers are not permitted to indemnify executive officers for required recoveries under the new rule.

Accounting Restatements

The three-year lookback period applies to a broad class of financial reports and accounting restatements. Under the final rules, clawbacks are triggered by accounting restatements where an issuer amends previously issued financial statements to correct material errors as well as restatements that are issued to correct errors that would simply "result in material misstatement if the errors were left uncorrected in the current report or the error correction was recognized in the same period." In a limited number of circumstances in accordance with general accounting standards, certain restatements circumstances will not trigger clawbacks, including (i) where an issuer makes an out-of-period adjustment that is immaterial to the current period and (ii) where errors exist as a result of (A) retrospective application of a change in accounting principle, (B) retrospective revision of reportable segment information due to a change in issuer's organizational structure, (C) retrospective reclassification due to a discontinued business function, (D) retrospective application of a change in reporting entity, (E) retrospective adjustment to provisional amounts in connection with a prior business combination (IFRS filers only) and (F) retrospective revision of stock splits, dividends or other changes in capital structure.

The SEC also adopted amendments to Item 402 of Regulation S-K, Form 40-F, Form 20-F, and, for listed funds, Form N-CSR, to include new disclosure requirements. Under these amendments, a listed issuer must file its executive compensation clawback policy as an exhibit to its annual report and disclose how it has applied the policy, including, as relevant: (i) the date it was required to prepare an accounting restatement and the aggregate dollar amount of erroneously awarded compensation attributable to such accounting restatement (including the estimates used in calculating the recoverable amount in the case of awards based on stock price or total shareholder return), (ii) the aggregate amount that remains outstanding and any outstanding amounts due from any current or former named executive officer for 180 days or more and (iii) details regarding any reliance on the impracticability exceptions.

This long-anticipated set of rules stems from proposals first published in July 2015. After a period of inaction on the topic, the SEC reopened the comment period for this set of proposed rules in October 2021 and again in June 2022. Continuing recent rulemaking trends, Chair Gensler echoed past statements in the

announcement by emphasizing the intent that this set of changes will strengthen transparency and corporate accountability to shareholders.

The final rules will become effective on January 27, 2023. Exchanges will be required to file proposed listing standards by no later than February 26, 2023, and the listing standards must be effective no later than one year following such publication. The new requirements do not apply to exchanges that do not list securities and trade exclusively pursuant to unlisted trading privileges.

Amendments to Rule 10b5-1: Insider Trading and Related Disclosures

On December 14, 2022, the SEC adopted amendments to Rule 10b5-1, which provides an affirmative defense to trading on the basis of material nonpublic information ("MNPI") in insider trading cases. The adopted amendments add new conditions to the availability of the affirmative defense available under Rule 10b5-1, create new disclosure requirements for issuers regarding insider trading policies and executive and director compensation, and update the Section 16 rules to require Section 16 filers to identify transactions made pursuant to a Rule 10b5-1 plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). The adopted amendments are designed to strengthen investor protections concerning insider trading by narrowing the scope of affirmative defenses and by mandating new disclosures to "help shareholders understand when and how insiders are trading in securities."

Updates to Rule 10b5-1 Affirmative Defense; Rule 10b5-1 Plans

Rule 10b5-1(c) establishes an affirmative defense to Rule 10b-5 liability for insider trading in circumstances where it is apparent that the trading was not made on the basis of MNPI because the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account or a written plan adopted when the trader was not aware of MNPI. Since the adoption of Rule 10b5-1, there has been concern that the existing affirmative defense under Rule 10b5-1(c)(1)(i) has allowed traders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of MNPI. There has also been concern that issuers abuse Rule 10b5-1 plans to conduct share repurchases to boost the price of the issuer's stock before sales by corporate insiders. To address these concerns, the SEC has adopted the amendments discussed below to narrow the availability of this af-

firmative defense and impose new procedural and disclosure obligations regarding its use.

“Cooling-Off” Periods

Prior to the adoption of these amendments, Rule 10b5-1(c)(1) did not impose any “cooling-off” period between the date a Rule 10b5-1 plan is adopted or modified and the date of the first transaction under the plan. Under the recently adopted amendments, directors and officers (which, for the purposes of this rule, is defined under Rule 16a-1(f) of the 1934 Act) will not be able to rely on the Rule 10b5-1 affirmative defense unless the Rule 10b5-1 plan imposes a cooling-off period that trading under such plan will not begin until the later of (i) 90 days following adoption or modification of such plan or (ii) two business days following the disclosure of the issuer’s financial results in a Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following adoption or modification of such plan). In addition, there will now be a 30 day cooling-off period requirement for persons other than directors, officers or the issuer before any trading can commence following the adoption or modification of a Rule 10b5-1 plan. A change to the amount, price or timing of the purchase or sale of securities pursuant to a Rule 10b5-1 plan will be deemed a modification to the plan, triggering the applicable cooling-off period described above. Even though some issuers impose their own cooling-off periods, the SEC noted that such periods are imposed voluntarily and vary in duration.

In a footnote to the adopting release, the SEC specifically declined to carve out from the definition of “officers or directors” certain “venture capital funds whose partners may serve as a director on the board of an issuer.” Based on this explicit carve out, the SEC would likely take the position that an investment fund that is, or may be deemed to be, a “director by deputization” by virtue of having representation on a board will be subject to the cooling-off period requirement.

Director and Officer Representations and Good Faith Condition

The amendments also add a condition that directors and officers must include representations in their Rule 10b5-1 plans certifying that at the time of the adoption of a new or modified plan that (1) they are not aware of any MNPI about the issuer or its securities and (2) they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5. The amendments also specifically require that all persons entering into a Rule 10b5-1 plan must act in good faith with re-

spect to that plan. This good faith condition is intended to help deter corporate insiders from trading opportunistically in connection with their plans and from inappropriately influencing the timing of company disclosures to benefit their trades under such plans.

Multiple Overlapping Plans and Single Trade Plans

The amended rules now prohibit insiders from using multiple Rule 10b5-1 plans during the same period, subject to certain exceptions. This is intended to address concerns with insiders who adopt multiple overlapping plans and subsequently selectively cancel certain trades under one plan while they are aware of MNPI, thereby allowing them to transact under the other plan(s) that provide the most beneficial price. There is also a new limitation on the availability of the affirmative defense for a single trade plan (i.e., a plan "designed to effect" the purchase or sale of the total amount of securities in a single transaction) to one such single trade plan during any consecutive 12-month period for all persons other than the issuer, subject to certain exceptions.

Enhanced Issuer Disclosure Requirements

Prior to the adoption of these amendments, there were no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by issuers or insiders. The SEC has expressed concern that the lack of disclosure deprives investors of the ability to assess whether those parties may be misusing their access to MNPI. The amendments adopted by the SEC create new disclosure requirements with which issuers and Section 16 filers will need to comply.

Quarterly Disclosures

Issuers will be required to disclose in their Forms 10-Q and 10-K (1) whether, during the most recently completed fiscal quarter, any director or officer has adopted or terminated (a) any contract, instruction or written plan for the purchase or sale of securities that is intended to satisfy the affirmative defense conditions of Rule 10b5-1, and/or (b) any written trading arrangement for the purchase or sale of securities that meets the requirements of a non-Rule 10b5-1 trading arrangement, and (2) a description of the material terms, other than pricing terms, of the Rule 10b5-1 trading arrangement or non-Rule 10b5-1 trading arrangement. Certain modifications of Rule 10b5-1 plans that constitute a termination of the existing plan and adoption of a new plan will also be required to be disclosed.

Insider Trading Policy Disclosures

Issuers will also now be required to disclose in their Forms 10-K and proxy statements whether the issuer has adopted insider trad-

ing policies and procedures and, if they have not adopted such policies and procedures, an explanation why they have not done so. If the issuer has adopted insider trading policies and procedures, it must file a copy of such policies and procedures as exhibits to the Form 10-K.

Equity Award and Option Grant Disclosures

In addition, issuers will now be required to provide tabular disclosure in their Forms 10-K and proxy statements of each award of stock options, SARs or similar option-like instruments granted to named executive officers during a window beginning four business days before the filing of a Form 10-Q or Form 10-K or the filing or furnishing of a Form 8-K that discloses MNPI (including earnings information), other than a Form 8-K disclosing a material new option award grant, and ending one business day after the filing or furnishing of such report. The tabular disclosure must be accompanied by narrative disclosure describing the issuer's policies and practices regarding the timing of the grants in relation to the issuer's disclosure of MNPI and whether the issuer has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation. Such tabular information will require XBRL tagging.

Modified Forms 4 and 5 Disclosures

Insiders who are Section 16 filers will now be required to indicate via a checkbox on the applicable Form 4 or 5 whether a reported transaction was made pursuant to a trading plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) and disclose the date of adoption of the trading plan. Also, bona fide gifts of securities by insiders that were previously permitted to be reported on a deferred basis on a year-end Form 5 will now be required to be reported on a Form 4 within two business days of the date such gift is made.

Effective Dates

The amendments will become effective 60 days following publication of the adopting release in the Federal Register. Issuers must comply with the new disclosure requirements in 1934 Act periodic reports and in any proxy or information statements beginning with the first filing that covers the first full fiscal period that begins on or after April 1, 2023 (October 1, 2023 for smaller reporting companies). Section 16 filers must comply with the applicable amendments for beneficial ownership reports filed on or after April 1, 2023.

Proposed Rules

Equity Market Proposals

Disclosure of Order Execution Information Proposal

The SEC proposed new rules to Rule 605 under Regulation

NMS to modernize disclosure requirements for order executions in national market system stocks ("NMS Stocks"), which are stocks listed on a national securities exchange. Rule 605 was adopted to help the public compare and evaluate execution quality among different market centers, but has not been substantively updated since its adoption in 2000 when it was originally adopted as Rule 11Ac1-5 of the 1934 Act. The SEC noted that the equity markets have drastically transformed with the improvement of technology over the years, prompting the need to amend Rule 605. Currently, Rule 605 requires national securities exchanges, alternative trading systems ("ATSs"), exchange market makers and OTC market makers to make standardized monthly reports available concerning the rates, speeds and pricing at which NMS Stocks are executed.

The proposed amendments:

- expand the scope of entities obliged to provide monthly reports under Rule 605 to include (i) broker-dealers that introduce or carry 100,000 or more customer accounts, (ii) single-dealer platforms and (iii) entities that would operate qualified auctions;
- amend the definition of "covered orders" to include certain orders submitted outside of regular trading hours and certain orders submitted with stop prices;
- amend the categorization of information required to be reported under Rule 605, including changing the order type categories and the order size categories to include fractional shares, odd-lots, and larger-sized orders;
- eliminate time-to-execution categories in favor of average and median times to execution, realized spread statistics and other statistical measures of execution quality in increments of a millisecond or finer;
- add a new category for marketable "immediate or cancel" orders, and three new categories to replace existing categories of nonmarketable; and
- would require all entities subject to Rule 605 to make standardized monthly reports available in XML and PDF formatting on the SEC's website; and

If implemented, this proposal could have a significant impact on broker-dealers as they work to build out internal systems capable of capturing necessary reporting information. Further complications are raised by the proposal regarding its applicability to broker-dealers that execute fractional share transactions due its unclear delineation between OTC market-making activity and single-dealer platform activity. The SEC believes that these amendments would increase data made available under to the public under Rule 605 about trade execution quality.

Additional Amendments to Regulation NMS

The SEC proposed new rules to amend the oft-maligned tick size rules under Rule 612 of Regulation NMS to establish a variable minimum pricing increment model that would apply to both the quoting and trading of NMS Stocks. When market participants submit orders to buy or sell shares of an NMS Stock, the difference between the best buy order and the best sell order is the “bid-ask spread.” Currently, quotations for NMS Stocks priced at, or greater than, $1.00 per share have a minimum pricing increment of $0.01, which prevents the bid-ask spreads for such stocks to be less than $0.01, while quotations for stocks priced less than $1.00 per share have a minimum pricing increment of $0.0001. The proposed amendment has been crafted in response to feedback from securities exchanges indicating that low-priced stocks are likely to be tick constrained, and furthermore that tick-constrained stocks, regardless of size, tend to exhibit higher levels of inaccessible liquidity and routinely trade in high volumes. The proposed amendment would introduce a new model to provide for a variable minimum pricing structure for quotes and orders in NMS Stocks priced at, or greater than $1.00 per share and require executions to occur in a minimum pricing increment, subject to certain exceptions, both for trades executed on national securities exchanges and OTC.

The SEC proposed to amend Rule 610 to recalibrate the caps that limit what a trading center can charge for the execution of orders against a protected quotation or any other quotation that is the best bid or best offer. For quotations in NMS Stocks priced at $1.00 or more, the access fee cap would be $0.0005 per share for NMS Stocks that have a minimum pricing increment of $0.001. The access fee cap would be $0.001 per share for NMS Stocks priced less than $1.00, and the access fee cap would be 0.05% of the quotation price. In addition, Rule 610 would be amended to prohibit a national securities exchange from imposing, or permitting to be imposed, any fee, or providing, or permitting to be provided, any rebate or other remuneration for the execution of an order in an NMS Stock unless such fee, rebate or other remuneration can be determined at the time of execution.

The final two proposed amendments to Regulation NMS would accelerate the implementation of the round-lot and odd-lot information definition that was adopted in 2020 under the Market Data Infrastructure Rules (“MDI Rules”) to distinguish these provisions from other parts of the rulemaking that will proceed on a more protracted timeline. The first of these rules would reduce round-lot sizes for high-priced securities greater than $250.00 per share and expand certain disclosures with respect to odd-lot orders that are priced better than the national best bid and

national best offer ("NBBO"). The final amendment would change the definition of odd-lot information under the MDI Rules in a manner that would require identification of the best odd-lot order.

Order Competition Proposal

Perhaps the most consequential change to Regulation NMS, the SEC has proposed a new rule to enhance order competition that would require most retail investor orders in securities to be exposed on a qualifying national securities exchange or ATS via new auction mechanisms ("open competition trading centers"). Proposed as Rule 615 of Regulation NMS, the core requirement of the rule states that certain orders from individual investors (deemed "segmented orders") must be exposed to competition in certain defined "qualified auctions" before such orders can be executed internally. The proposed rules if adopted may significantly alter the current "payment for order flow" model that enables brokers to earn fees for directing orders for trade execution to market makers.

Pursuant to the proposed new rules, segmented orders would be defined to include orders for NMS Stocks made for an account (i) of a natural person or held in legal form on behalf of a natural person or group of related family members and (ii) in which the average daily number of trades executed in NMS Stocks was less than 40 in each of the preceding six calendar months. Such orders are already segmented in practice, but the proposed definition was added in order to facilitate compliance as broker-dealers would theoretically have familiarity with identifying orders from these accounts in other contexts, such as through compliance with Regulation Best Interest and through certain retail liquidity programs offered by exchanges that are limited to participation by such natural persons, and, in turn, require broker-dealers to identify customers. Additionally, a number of exceptions would apply to this definition, somewhat limiting the scope of the proposed rule. First, segmented orders received and executed by a restricted competition trading center (under the proposed rule meaning any trading center that is not an "open competition trading center," such as any wholesalers) during a time period in which no open competition trading center is operating a qualified action for the segmented order need not comply with the proposed rule, as it would be impossible. A second exception to proposed Rule 615 applies for large orders with a market value of at least $200,000 calculated in reference to the NBBO midpoint when the order is received by a restricted competition trading center. This exception follows the dollar thresholds established elsewhere in Regulation NMS and is designed to address the heightened liquidity need of large orders that may be more appropriately ad-

dressed outside a qualified action. Other exceptions apply for segmented orders executed by restricted competition trading centers at a price that is equal to the NBBO midpoint or more favorable to the segmented order, those with a limit price selected by the customer that is equal to or more favorable for the NBBO, and lastly for fractional share orders (where the dollar size of an order is less than the share price for that particular NMS Stock).

Currently, individual investors primarily use market orders and marketable limit orders to trade in NMS stocks. Broker-dealers route more than 90% of these orders to a small group of off-exchange wholesalers that in turn capture the majority of trading volume and pay compensation for order flow to such broker-dealers. The proposal seeks to reflect SEC data analysis that opening up individual investor orders to competition would lead to significantly better prices and lower transaction prices for those investors by mandating a fully competitive market.

Proposed Rule 615 does provide flexibility for how broker-dealers, wholesalers and other trading centers comply with the rule, and ultimately would allow covered orders to continue to be executed internally so long as there has been exposure on an order-by-order basis to a qualified auction.

Regulation Best Execution Proposal

The SEC proposed a series of rules that would establish a new regulatory framework for the best execution of trades for brokers, dealers, government securities brokers and dealers, and municipal securities dealers (collectively, "broker-dealers"). If adopted, the proposed rule will be the first SEC rulemaking on the subject, but broker-dealers would be required to continue to comply with existing rules governing the subject, including FINRA Rule 5310 and Municipal Securities Rulemaking Board ("MSRB") Rule G-18.

The proposed rules create a new regulation that would be called Regulation Best Execution ("Regulation Best Ex"), which would primarily aim to mandate new policies and procedures governing practices for the best execution of trades by broker-dealers, impose additional requirements for conflicted transactions and impose best execution-specific review and documentation requirements.

Proposed Rule 1100

Proposed Rule 1100 of Regulation Best Ex sets forth the substantive best execution standard for covered broker-dealers by requiring that in any transaction for or with a customer, reasonable diligence must be undertaken to ascertain the best market for the buying or trading of any particular security, and that such best market must be selected to execute the transaction so that

the customer receives the most favorable price under prevailing market conditions. Proposed Rule 1100 also provides that certain transactions are exempt from the aforementioned diligence process, namely when (i) another broker-dealer is executing a customer order against the broker-dealer's quotation, (ii) an institutional customer (not currently defined in the proposal), exercising independent judgment, executes its order against the broker-dealers quotation and (iii) the broker-dealer receives and processes an unsolicited instruction from a customer to route its order to a particular market for execution. This standard generally mirror's FINRA Rule 5310, minus the second exemption described above.

Proposed Rule 1101

General policies and procedures for Regulation Best Ex, including those governing conflict transactions and quality review, are set forth under proposed Rule 1101. First, Rule 1101 would require broker-dealers to establish, maintain and enforce written policies in compliance with Regulation Best Ex that specify elements designed to promote the best execution of customer orders and comply with certain quality review and documentation requirements. In particular, these policies and procedures would be required to address how a broker-dealer would (i) obtain and assess reasonably accessible information, such as information about price, volume, and execution quality, concerning the markets trading the relevant securities, (ii) identify markets that may be reasonably likely to provide the most favorable prices for customer orders (referred to as "material potential liquidity sources") and (iii) incorporate the material potential liquidity sources into its order handling practices to ensure efficient access to each such material potential liquidity source. Proposed Rule 1101 would additionally require that broker-dealer policies and procedures outline how determinations are made as to the best market for routing and execution of customer orders based on evaluation of the criteria above.

Proposed Rule 1101(b) creates new requirements for dealing with "conflicted transactions" beyond those currently required by FINRA or the MSRB and provides that broker-dealers specifically document how such transactions are conducted in accordance with the policies and procedures mentioned above in a manner beyond that which would be normally required. Conflicted transactions is defined under Regulation Best Ex as any transaction for or with a retail customer where a broker-dealer (i) executes an order as principal, including riskless principal (where, for example, a broker-dealer purchases the security from another person to offset a contemporaneous sale to the customer),

(ii) routes an order to or receives an order from an affiliate for execution or (iii) provides or receives payment for order flow as defined under the 1934 Act. The SEC stated in the proposal that the intention of adding heighted procedural requirements for conflicted transactions would assist broker-dealers with maintaining general compliance with Regulation Best Ex while also providing particular benefit to retail customer that may have fewer resources for evaluating the best execution practices of their broker-dealers.

The SEC also proposed to adopt Rule 1101(c), which provides, at a minimum, that broker-dealers conduct quarterly review of the execution quality of transactions against other broker-dealers and other markets, and Rule 1101(d), which would permit a broker-dealer that qualifies as an introducing broker-dealer to rely on its executing broker to satisfy its compliance with the totality of proposed Rule 1101, subject to certain review requirements.

Proposed Rule 1102

Proposed Rule 1102 would require that annual reviews be similarly conducted and documented by covered broker-dealers with written reports presented to the entity's board of directors or similar executive body. Further to these review requirements, the proposed rulemaking would also amend 1934 Act Rule 17a-4 to require broker-dealers to preserve records made pursuant to Regulation Best Ex.

Conclusion

The policies and procedures prescribed under Regulation Best Ex are largely consistent with the factors and accompanying obligations already identified by FINRA and the MSRB. The SEC stated in its release that the proposed rulemaking seeks to supplement existing frameworks by providing standardization of requirements and by heightening the attention paid to the handling of certain order conflicts. Ultimately, this proposed rulemaking is a policy and procedures rule. If implemented as proposed, a broker-dealer would not necessarily be penalized for failure to achieve most favorable pricing for customer orders, so long as such broker-dealer maintains reasonably designed policies and enforcement mechanisms applicable to all customer orders.

Southern District of New York Dismisses Complaint Against Biopharmaceutical Company for COVID-19 Vaccine Trials

On September 12, 2022, the Southern District of New York,

Judge Paul Oetken, dismissed a complaint against AstraZeneca PLC (the "Company") brought by shareholders alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act.

The Company is a biopharmaceutical company, which in April 2020, partnered to develop a potential COVID-19 vaccine. The Company made regular disclosures and issued press releases concerning the Phase I/II trials in April 2020 and then Phase II/III trials in June 2020. The Company continued to issue updates about the clinical trials and their results in October and November 2020. Plaintiffs allege the Company made misstatements regarding clinical trials of its COVID-19 vaccine. Specifically, misrepresentations concerning manufacturing and subsequent dosing errors, the number of patients in a certain age group in the trials, broadly, that the Company failed to disclose its failures to follow protocols and guidelines.

However, pursuant to the Private Securities Litigation Reform Act (the "PSLRA"), Plaintiffs were required to plead their allegations with particularity. Ultimately, Plaintiffs failed to adequately allege the how and why the alleged misstatements were false or misleading, or made misleading by any alleged omission. The Court considered each alleged omission and determined either, there was no omission, the statements were in fact accurate, were typical puffery, or the statements were of little impact and not the basis for liability. For example, in reiterating that there is no duty to disclose negative facts, the Court stated Plaintiffs allegations failed because they were "akin to saying that the absence of a negative disclosure gave the impression that there were no negative facts. Were that the standard, every omission would be actionable."

In addition, the Court held that Plaintiffs failed to adequately allege a strong inference of scienter. Plaintiffs attempt to plead a motive among the corporate officers failed because motives such as completing an acquisition or gain prestige for a viable vaccine are "common." Plaintiffs further failed to allege facts sufficient for "strong circumstantial" evidence of conscious misbehavior or recklessness. And finally, Plaintiffs failed to allege the Company's knowledge of facts contrary to the disclosures the Company made in an FDA report.

In re AstraZeneca PLC Sec. Litig. (S.D.N.Y. Sept. 12, 2022) decision available at https://www.law360.com/articles/1529727/attachments/0.

Trial Looms in Northern District of Texas Ponzi-Scheme Action

On January 3, 2023, the Northern District of Texas, Dallas Division, granted in part and denied in part a summary judg-

ment motion filed by the defendant, the clearinghouse Pershing (the "Company"), a subsidiary of Bank of New York Mellon. A decade ago, investors sued the Company for losses tied to a $7 billion Ponzi scheme orchestrated by R. Allen Stanford and his company the Stanford Group Co. The Company was the clearing broker for the Stanford Group Co. from December 2005 to December 2008, when the fraud was conducted. The case will proceed to trial, though no trial date is currently set.

The suit was originally filed by investors in 2009 over R. Allen Stanford's misappropriation of investors' certificates of deposits. The complaint alleged that as the clearing broker, the Company protected the scam in order to benefit from the profits it earned from the sale of the fictitious certificates of deposit, allegedly selling over $500 million in deposits. Plaintiffs also alleged the Company aided and abetted the sale of unregistered certificates of deposit to allow the Stanford Group to transfer hundreds of millions out of its investors' security accounts.

The Court granted the Company's motion on investors' common law claim for aiding and abetting breach of fiduciary duty, holding that no such cause of action exists under Texas law. The Court also granted the Company's motion on intervening plaintiffs' claims for registration violations and for untruths or omissions under the Texas Securities Act (the "Act") that were brought in 2019, holding that those were time-barred.

However, the Court denied the Company's motion as to Plaintiffs' claims for aiding and abetting violations of the Act. The opinion noted evidence that the Company assisted Stanford with its "strategic efforts" and that the Company's services were "not merely ministerial." Such evidence included the Company marketing itself to Stanford as a "strategic partner," which is not common among clearing houses; multiple instances where the Company described itself as in a partnership with Stanford; and the Company assisting Stanford with recruiting and transitioning of financial advisors. There was also a written agreement that allowed the Company to "refuse to confirm a transaction or cancel a transaction," "reject a delivery or receipt of securities or money," or "refuse to clear a trade." The Court ultimately held that there were questions of fact "[i]n the face of the contractual language and extensive services the Company offered beyond those of a mere clearing broker." The Court also rejected the Company's argument that the unregistered securities provisions of the Act do not apply to investors.

Investors claim that the Company willfully ignored irregularities in Stanford's business because it benefitted from the sales. Plaintiffs alleged that Stanford conducted offshore transfers and awarded brokers outsize compensation, all of which the Company

was aware of and turned a blind eye to. Stanford also refused to cooperate with the Company's audits and refused to provide information over the years, which the Company routinely asked for.

Lynne Turk et al. v. The Company LLC, 3:09-cv-02199-N-BQ (N.D. Tex. Jan. 3, 2023)